HSBC

David D. Gibbons
Senior Executive Vice President
Chief Risk Officer

VIA OVERNIGHT MAIL

December 12, 2006

Mr. John C. Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E. Street, SW
Washington, DC 20219

Ms. Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Mr. Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. John C. Reich
Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Re: Notice of Proposed Rulemaking - "Risk Based Capital Standards: Advanced Capital Adequacy Framework" 71 FR 55830 (September 25, 2006)

Dear Ms. Bair and Mssrs. Dugan, Bernanke, and Reich:

HSBC North America Holdings Inc. ("HSBC North America") welcomes the opportunity to comment on the Risk Based Capital Standard: Advanced Capital Adequacy Framework Notice of Proposed Rulemaking (the "NPR") issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (collectively, the "Agencies"). This letter provides initial comments on the NPR that we anticipate later supplementing with more detailed comments on specific aspects of the NPR and related supervisory guidance.

HSBC North America is a bank holding company that offers a wide range of financial services through bank and non-bank subsidiaries in the United States, Canada, and the United Kingdom. Our largest bank subsidiary, HSBC Bank USA, N.A., Wilmington, Delaware, operates more than 400 branches, which are located in the states of New York, New Jersey, Florida, Pennsylvania, California, Washington, Oregon, and the District of Columbia. HSBC North America also owns HSBC Finance Corporation, which issues consumer credit cards through HSBC Bank Nevada, N.A., Las Vegas, Nevada, and consumer loans and mortgages through state licensed entities. HSBC

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North America is a subsidiary of HSBC Holdings plc ("HSBC Group"), a banking organization based in the United Kingdom with operations in 80 countries.

With balance sheet assets of almost $500 billion, HSBC North America will be a "core" bank for purposes of Basel II in the United States (as currently prescribed) and thus required to implement the advanced internal ratings based ("A-IRB") approach for credit risk and the advanced measurement approach ("AMA") for operational risk with an "earliest possible" effective date of January 1, 2009. Additionally, as a wholly owned subsidiary of HSBC Group, HSBC North America is also subject to the implementation schedule and capital rules as adopted for host jurisdictions by the UK Financial Services Authority ("FSA"), HSBC Group's home supervisor.

HSBC North America supports the principles of Basel II. Specifically, we concur that large complex banking organizations should have robust risk management, regulatory capital should be sensitive to business risk, and the regulatory capital regime should be applied consistently among industry participants. In this regard, we support the Agencies' work to advance Basel II in the United States. Further, as an international organization, HSBC Group strongly supports the implementation of a global capital accord applied consistently in all major banking jurisdictions.

With that preface, we cannot support the NPR in its current form. In many important areas, the proposed rule diverges sharply from both established internal risk management principles and international standards, imposing an extra layer of regulation on "core" banks without providing corresponding risk management benefits. In doing so, the NPR moves away from achieving one of the Basel Committee's principal objectives – that of creating a consistent global capital standard. We fear the result of this regulatory framework could be to disadvantage United States banking organizations required to abide by its provisions and discourage other banking organizations from voluntary participation. In a world of global capital markets, requiring inefficient allocation of capital and operational resources by United States banking organizations could have a direct negative economic impact on those institutions as well as the broader banking industry and, especially, the capital and credit markets in the United States.

In particular, the NPR contains requirements that differ significantly from the international framework adopted by the Basel Committee on Banking Supervision, in which the United States is an active participant, as well as from the Capital Requirements Directive ("CRD") as implemented by the FSA. The NPR's more significant variances include:

- Use of only the advanced approaches;
- Different definitions of "default";
- Extended transitional floor periods;
- Multiple Loss Given Default ("LGD") calculations;
- Different treatment for insurance subsidiaries; and

Introduction of a 10% aggregate industry capital reduction floor.

We submit that these variances are unnecessary and would carry significant negative consequences for the organizations subject to them. In addition, many of these variances place arbitrary elements into the calculation of regulatory capital that will result in capital levels which do not accurately account for risk. This inefficient use of capital could place banking organizations in the United States who are subject to the rule at a significant competitive disadvantage when measured against other lending institutions and could even discourage certain types of lending operations.

Of equal concern to us is the additional economic cost of implementing and maintaining compliance systems for multiple layers of redundant regulation, draining resources otherwise available for ongoing risk management activities. To that end, we are especially concerned with:

- The daunting task of ensuring compliance on a concurrent basis with the capital rules of multiple jurisdictions, which would require maintaining duplicate data sets and documentation references, as well as meeting multiple reporting standards.
- The requirement that we revalidate, under the Agencies' rules, models which have already been established and certified by other supervisors such as the FSA.
- To the extent that banking organizations are required to develop and maintain separate models to comply with standards which vary by jurisdiction, the logical impossibility of certifying that an institution uses every model.
- To the extent that arbitrary factors are included in capital calculations, the risk that capital is inappropriately allocated between portfolios.
- The inefficiency created by implementing prescriptive models (for instance, in the case of retail credit risk management) which do not correspond to established industry practice.
- The fact that the complexity provided by the NPR's various floors, scaling factors, transitional approvals, and required layers of conservatism would discourage institutions from adopting the advanced approaches.

And beyond these issues of cost and practicality, the prescriptive nature of the framework set forth in the NPR distances the rule from established principles of sound capital management. Thus, the NPR achieves neither consistency with international standards, nor with sound capital management techniques.

For this reason, consistent with the Basel Committee's goal to create a global capital standard, we would recommend that the requirements of new capital rule in the United States be harmonized with those of the Basel Committee. If United States policy considerations defeat such a possibility, we would suggest adherence to the Basel Committee's stated position, reiterated in its paper entitled "Home-host information sharing for effective Basel II implementation" issued June 2, 2006, advocating the need for a "pragmatic approach" in areas open to national discretion to avoid redundant or uncoordinated qualification and approval work. Further to this point, we fear that outstanding home-host issues have not been sufficiently addressed. Dialogue should be continued with other primary supervisors on the "home-host" concept of mutual acceptance and flexibility, particularly with respect to using "home" rules and governance for internationally managed lines of business and "host" rules and governance for locally managed ones. As a banking organization operating on a global scale, the lack of clear agreement on mutual acceptance among our primary supervisors is a matter of significant concern.

In essence, we would suggest development of an approach less prescriptive than set forth by the NPR, but which still could provide the Agencies with sufficient authority to review an institution's capital measures through the supervisory review process (Pillar II) to ensure stable and sufficient capital levels are maintained at individual institutions. This practice has been successfully implemented by the Agencies within the current capital adequacy framework, and we see no reason for it to be discontinued under the new rules.

Another alternative would be to allow core banking organizations based in the United States the option of adopting the Basel II Standardized Approach for calculating regulatory capital under Pillar I, while requiring the broad principles of A-IRB, AMA, and Economic Capital as matters of safety and soundness under Pillar II. This could be accomplished through the issuance of large bank "safety and soundness standards" as part of, for example, the "Interagency Guidelines Establishing Standards for Safety and Soundness."[1] Such additional requirements, similar to existing guidance from the Board of Governors of the Federal Reserve System entitled "Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations,"[2] could require large complex banking organizations to develop and use advanced internal risk management techniques appropriate to the internal risk profile of the organization. This approach would provide the Agencies both with transparency into an organization's risk management practices and internal capital models, as well as (as they currently have today) the ability to require higher capital as deemed necessary. At the same time, this approach would provide a more consistent capital framework among large United States banking organizations and their competitors based in foreign jurisdictions who do business in the United States, thereby creating a more level competitive playing field. This approach would also advance risk management practices among large U.S. banking organizations and provide the Agencies with improved ability to align capital with risk through the existing supervisory process. And by eliminating those portions of the NPR that diverge significantly from international standards, this approach would reduce unjustified regulatory costs and the significant compliance issues resulting from layered, differing home and host country regulatory schemes. In adopting such an approach, the Agencies would thereby promote investment by large banking organizations in sound, advanced risk management processes, rather than in processes created solely to perform complex compliance exercises.

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[1] See e.g., Appendix A to 12 C.F.R. Part 30.
[2] SR 99-18 (July 1, 1999).

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Again, HSBC North America appreciates this opportunity to submit these comments on the approach taken by the NPR, and I would be pleased to discuss these issues further. Please note that it is our intention to submit additional, specific comments on the NPR in correspondence to follow this letter.

Yours truly,

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